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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 1025

DIXIE MACHINE WELDING & METAL WORKS, INC.,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. 53–61) is reported at 207 F. Supp. 84. The opinion of the court of appeals (Pet. 31–52) is not yet officially reported.

JURISDICTION

The judgment of the court of appeals was entered on March 21, 1963. (Pet. 62.) The petition for a writ of certiorari was filed on April 17, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether payments made by a ship-repair yard to officers of foreign ships are deductible as ordinary

and necessary business expenses under Section 23(a)(1)(A) of the 1939 Code, where the payments violated the Louisiana commercial bribery statute and also contravened Louisiana public policy as defined by the decisions of its highest courts.

STATUTES INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) [as amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—
>
> (1) *Trade or business expenses.*—
>
> (A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *
>
> * * * * * *
>
> (26 U.S.C. 1952 ed., Sec. 23.)

9 West's Louisiana Statutes Annotated (Rev.):

> SEC. 14.73. *Commercial bribery*
>
> Commercial bribery is the giving or offering to give, directly or indirectly, anything of apparent present or prospective value to any private agent, employee, or fiduciary, without the knowledge and consent of the principal or employer, with the intent to influence such agent's, employee's, or fiduciary's action in relation to the principal's or employer's affairs.
>
> The agent's, employee's, or fiduciary's acceptance of or offer to accept, directly or indirectly, anything of apparent present or prospective

value under such circumstances shall also constitute commercial bribery.

The offender under this article who states the facts, under oath, to the district attorney charged with prosecution of the offense, and who gives evidence tending to convict any other offender under this article, may, in the discretion of the district attorney, be granted full immunity from prosecution for commercial bribery, in respect to the particular offense reported.

Whoever commits the crime of commercial bribery shall be fined not more than five hundred dollars, or imprisoned for not more than one year, or both.

STATEMENT

Taxpayer is a corporation engaged in the ship-repair business in New Orleans, Louisiana. During its fiscal years ended June 30, 1951, and June 30, 1952, repairs on foreign ships accounted for a substantial part of taxpayer's total business. Generally, repair work to be done on foreign ships is let out by the ship's captain and chief engineer, who have the sole prerogative of selecting the ship-repair yard. During the years in question, foreign ships, upon arrival in the Port of New Orleans, were met by representatives of the taxpayer who attempted to solicit their repair business. It was generally known that taxpayer was willing to pay the officers of foreign ships a percentage of the repair bill as an inducement. According to taxpayer, the captain and chief engineer expected these payments and, if disappointed, would not have

assigned the taxpayer their repair work or encouraged the crew to cooperate during the performance of that work. Accordingly, it was taxpayer's practice to pay a kickback of approximately 10 percent of the repair bill to the captain and chief engineer of all foreign-owned ships repaired by it. Such payments were not made to officers of American ships because repair work on those ships is let out by American agents rather than by the captain and chief engineer.

The repair jobs on foreign ships were performed on a time-and-material basis. After the bill for actual man-hours and materials had been computed, an amount of 14 to 15 percent was added to it to cover the 10 percent kickback to the ship officers, plus 4 to 5 percent for withholding tax purposes. This additional amount was not specifically earmarked, but was included in the bill by inflating the number of man-hours spent on the job.

Upon completion of the repairs, taxpayer's representative carried the invoice to the ship for approval, at which time the captain and chief engineer were given sealed envelopes, each containing approximately 5 percent of the repair bill in cash. No receipts were obtained. The invoice, approved for payment, was then sent either directly to the owners or to their agents in the United States (Pet. 35–37).

Kickbacks totalling $41,940.01 and $79,311.43, for the fiscal years 1951 and 1952 respectively, were claimed as deductions by taxpayer in its income tax returns for those years. The District Director disallowed the deductions on the grounds that the pay-

ments, made without the knowledge and consent of the shipowners, violated the Louisiana commercial bribery statute. The district court held that the kickbacks were not deductible because they violated Louisiana's public policy as evidenced by its commercial bribery statute and by the decisions of its highest courts. (Pet. 37, 59–61.) The court of appeals affirmed.

ARGUMENT

In its opinion in *Tank Truck Rentals* v. *Commissioner*, 356 U.S. 30,[1] the Court confirmed the implications of its prior decisions[2] and made clear that expenditures which violate State criminal law may not be deducted as "ordinary and necessary" business expenses. Disallowing a deduction for fines imposed on the taxpayer for violating State maximum weight laws, the Court said (356 U.S. at 35):

> Certainly the frustration of state policy is most complete and direct when the expenditure for which deduction is sought is itself prohibited by statute. See *Boyle, Flagg & Seaman, Inc.* v. *Commissioner*, 25 T.C. 43. If the expenditure is not itself an illegal act, but rather the payment of a penalty imposed by the State because of such an act, as in the present case, the frustration attendant upon deduction would be only slightly less remote, and would clearly fall within the line of disallowance. * * *

[1] See also *Hoover Express Co.* v. *United States*, 356 U.S. 38, a companion case.

[2] See *Textile Mills Corp.* v. *Commissioner*, 314 U.S. 326; *Lilly* v. *Commissioner*, 343 U.S. 90, 94–95; *Commissioner* v. *Heininger*, 320 U.S. 467, 473–474.

Since the payments involved in this case were made in violation of the State's commercial bribery law,[1] they were plainly nondeductible under the rationale of the *Tank Truck Rentals* decision.

Nor does *Commissioner* v. *Sullivan*, 356 U.S. 27, relied upon by petitioner, require a contrary result. *Sullivan*—which was decided the same day as *Tank Truck Rentals* and, like it, by a unanimous Court—is distinguishable both from it and from the decision below in that it involved expenses, rent and wages paid by a bookmaker, which were only remotely related to the taxpayer's illegal conduct.[2] In allowing a deduction, the Court stated (p. 29) that "[t]he policy that allows as a deduction the tax paid to conduct the business seems sufficiently hospitable to allow the *normal* deductions of the rent and wages necessary to operate it." (Emphasis added.) The illegal bribes involved here cannot be deemed "normal" in the same sense as rent and wages.

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[1] In addition to the payments being in violation of Louisiana's commercial bribery statute, both courts below noted (Pet. 51, 59–60) that the padding of repair bills is a species of fraud forbidden by Louisiana's criminal statute, and that the illegal nature of the transaction is further indicated by Louisiana's judicial decisions.

[2] The court below, in distinguishing *Sullivan* (Pet. 48–51) correctly pointed out that there was no statute in Illinois making it a crime for a gambler to pay his rent and wages; the payments could be considered illegal only because bookmaking itself was illegal or because of the general provisions of the Illinois aiding and abetting statute. Although the government contended in *Sullivan* that the payments were violative of Illinois law, the Court's opinion, citing *Commissioner* v. *Heininger*, *supra*, indicates that the payments were only remotely related to an illegal act.

Equally inapplicable is *Paramount Finance Co.* v. *United States*, 304 F. 2d 460 (C. Cls.). There the court refused to find that the rebates controverted any sharply defined public policy, since the Ohio Department of Insurance, which knew about the arrangement, did not advise the parties to discontinue or alter it. No such circumstances obtained here.[1]

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1963.

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[1] Nor is *Speiser* v. *Randall*, 357 U.S. 513, 524, apposite here. That case did not involve any asserted right to a deduction under the federal tax law. Moreover, in sustaining the right of honorably discharged veterans to a property tax exemption under California law, without the requirement of filing a loyalty oath, this Court was obviously concerned with safeguarding "against invasion speech which the Constitution protects"—a consideration not at all present in the instant case.